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THESIS

Accounting Terminology
and Forms
in
Forty Annual Reports

by

Ralph Peter Schmitt
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Submitted in partial fulfillment of
the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION



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INTRODUCTION

The annual report of a corporation is one of its public relations tools. Most corporations have realized this and have included in their reports much more than just financial information and comments on the financial position of the company. The language used in annual reports requires a good knowledge of financial terms. In order to present more information to the stockholders and other readers of their annual reports, one thing corporations have done is to add to the annual report information about how the company operates and something about their product. Another thing they have done is to include a great deal more graphical and pictorial presentation of information regarding growth of the company, operations, and about the financial status of the company. A third change has been an effort to change the accounting terminology appearing in their annual reports so that the words used therein make sense to the average reader or at least connote the same thing to the readers of the report as they do to the accountant who has made up the statements.

Corporations have also included forms or statements other than the balance sheet and income statements. These statements are intended to clarify items of the income statement or balance sheet or to present other financial

(Letter sent requesting annual reports.)

19 Freeman Street
Arlington, Mass.
October 10, 1948

Northern States Power Company
Sioux Falls
South Dakota

Gentlemen:

In connection with my studies as a graduate student at Boston University I am writing a thesis in which I am making a study of the accounting terminology used in annual reports.

If I may use it, I should like to have a copy of your latest annual report available to use in connection with my thesis.

Yours very truly,

Ralph P. Schmitt

information of interest to the stockholder or other reader of their report .

It is the accounting terminology in annual reports and the forms used in the reports with which I shall deal in this thesis. In an article in the Journal of Accountancy on "Trends in Accounting Terminology" it is said that in their present form financial statements are designed for readers who have had some training in accounting theory and terminology and that the average investor, employer, or customer does not qualify in this respect. - ⁽¹⁾ In the same article it is said that the public has either ignored financial statements or has little confidence in them since they cannot understand them. ⁽²⁾ In other words, if one cannot understand the jargon of accounting used in the statements he might be inclined to have little faith in it, believing that perhaps the language is being used to cover some adverse facts.

On the other side of the picture, if a drastic change were suddenly made, the public might think that such a change had been made because the company had something to ⁽³⁾ hide or was covering up in some way.

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1. Journal of Accountancy, "Trends in Accounting Terminology," Williams, Aubrey, Oct., 1947, p. 310.
 2. Ibid
 3. See editorial in Journal of Accountancy, March, 1948 p. 186, on "Press Reports of Accounting Data," for example.
 4. Stans, M. H., "How New Standards of Financial Reporting Grow from Social Responsibility of Accountants," Journal of Accountancy, August, 1948, p. 105.

ANNUAL REPORTS USED

Aluminum Company of America
American Telephone and Telegraph Co.
American Woolen Company
Armstrong Cork Company
Boston Edison Company
Carrier Corporation
Caterpillar Tractor Company
Chrysler Corporation
Container Corporation of America
Continental Can Company
Crane Company
Diamond Match Company
General Mills Company
General Motors Corporation
Hoover Ball and Bearing Company
Kaiser-Frazer Corporation
Libbey-Owens-Ford Glass Company
McKesson and Robbins, Inc.
National Battery Company
New England Telephone and Telegraph Co.
Northern States Power Company
Northwestern Public Service
Philco Corporation
Philip Carey Manufacturing Company
Pittsburgh Steel Company
Proctor and Gamble Company
Radio Corporation of America
Ralston Purina Company
Remington Rand
Sears, Roebuck and Company
Spalding, A. G., and Bros., Inc.
Standard Oil (New Jersey)
Swift and Company
The Texas Company
Timken Roller Bearing Company
United States Rubber Company
United States Steel Company
Westinghouse Electric Corporation
Wilson and Company
Zenith Radio Corporation

Therefore, it would seem that changes in the language of accounting must necessarily be slow. Another reason the changes will probably be slow is because the background of some terms such as "balance sheet," "reserve," and "surplus" is so invested with tradition that it seems almost impossible to bring about a change. (4)

In this thesis I will treat certain of the terms appearing in the balance sheets and pro fit and loss statements of forty different corporations. The terms I shall discuss will be those in which I have found variations in the usage of, or where I have found differences of opinion in various references as to what use should be made of the word. The thesis will also include discussions of what words have been recommended by various sources as substitutes for the more common phraseology.

I shall begin with the title of the first statement, the Balance Sheet. After taking up various other items of the Balance Sheet I shall take up the Profit and Loss Statements.

My procedure has been as follows: I sent a letter (appearing on page 5) to fifty corporations in all parts of the United States. These corporations were of various sizes, ranging from smaller corporations such as Hoover Ball and Bearing Company to such giants as United States

4. Stans, M. H., "How New Standards of Financial Reporting Grow from Social Responsibility of Accountants," Journal of Accountancy, August, 1948, p.105.

Steel. Among these were five public utilities and one retailing corporation. The other thirty-four were manufacturers or food processors. I received replies and their annual reports from forty companies. Two replied stating that they did not publish an annual report because the holdings of their companies were not widespread enough to warrant publishing an annual report. A list of the corporations whose annual reports I used appears on Page

As I came to each item of either statement I intended to treat, I went through the statements and tabulated the treatment of that item by each company. I supplemented and supported my comments by references to various books on accounting, the Securities and Exchange Commission S-X Bulletin, the Journal of Accountancy, and Accounting Research Bulletins of the American Institute of Accounts. From those sources and from my own observations I made comments, both pro and con, on the uses of the various words and phrases.

CHAPTER II

THE BALANCE SHEET

The first item of terminology to be discussed here is "Balance Sheet." First, before finding what the companies did in their annual reports about the caption for this statement, what is a balance sheet? The Committee on Terminology of the American Institute of Accountants defines a balance sheet as "A tabular statement or summary of balances (debit and credit) carried forward after an actual or constructive closing of books of account kept by double-entry methods according to the rules or principles of accounting. The items reflected on the two sides of the balance sheet are commonly called assets and liabilities, respectively."⁽¹⁾ The left-hand side shows the debit balances (in some cases, the debit balance after deducting a related credit balance--as when deducting reserve for depreciation from a fixed asset); and the right hand side is a summary of credit balances. Since a double entry system of keeping accounts is involved, the two sides balance, hence the name "Balance Sheet."

In this group of annual reports there were but five statements of assets, liability, and net worth that are not

1. Accounting Research Bulletin #9 (special), May, 1941, p.88-9

headed "Balance Sheet" or "Consolidated Balance Sheet." The five annual reports in which I found the variations are those of Armstrong Cork Company, Caterpillar Tractor Company, General Mills, Inc., United States Steel, and Westinghouse Electric Corporation.

Armstrong Cork put two statements of asset and liabilities in their annual report. The first is headed "Statement of the Company's Position." The second is headed "Balance Sheet." Those two statements were set up in different forms. The first is set up in a form that deducts the liabilities from the assets, arriving at the net worth. The second is set up according to the usual accounting equation: $\text{assets} = \text{liabilities} + \text{net worth}$.

The Caterpillar Tractor Company and General Mills, Inc. titled their statements "Statement of Financial Position," and Westinghouse Electric called their balance sheet "Statement of Ownership". In each of these cases the variation in title from "Balance Sheet" was accompanied by a difference in the form. In all five cases liabilities were deducted from assets at one stage or another and the balance, net worth, was broken down into capital stock and net worth. The balance of

the annual reports called this statement by the term "Balance Sheet." All those Balance Sheets were in the form of the equation mentioned above.

The five variations noted above all express the actual meaning of the statement perhaps better than the term "Balance Sheet." "Statement of Financial Position" or "The Companies' Position" say to the reader "Here is a statement of how we stand as regards our financial health, and here is where the net worth figure comes from." The term "Balance Sheet" seems merely to indicate that this is a statement that the debit and credit items balance. The statement is really a statement of how the company stands financially. It would seem reasonable to use a title for the statement that would explain that fact and take out a little of the mystery of the "balance."

Westinghouse Electric's title "Statement of Ownership" is a little different from the others. This heading tells the reader what he is going to find when he reaches the bottom of the statement---what the stockholders' equity in the company is and what items make up that equity. All the variations in the titles of the statement were accompanied by a change in form. The title of the statement does not matter as much as its content and form; but as has been mentioned above, the value of the title "balance"

has been questioned. There is no doubt, however, that the term and the balancing form have been used in the group of annual reports much more than any other caption or form. In the future there may be a greater trend toward more expressive titles.

CURRENT ASSETS

The first usual heading in the asset section of the balance sheet is "Current Assets." The term "current" implies that there is something about the present or the liquidity of the assets in the nature of items coming within the classification of current assets. Current assets are cash and other assets that will be converted into cash in the near future in the normal operation of the business. ⁽¹⁾ This generally includes cash inventories, and receivables. It is commonly recognized that current assets should be those that will be converted into cash within a period of one year or within the accounting period. The conversion period of one year may be somewhat arbitrary. Regulation S-X of the Securities and Exchange Commission, Rule 3-13, states the following about current assets: "Items classed as current assets shall be generally realizable within one year." ⁽²⁾ It goes on to say that recognized trade practices may be followed with respect to such items as inventories in long process pro-

1. Finney, H.A., Intermediate Accounting, Ch.3, p.54
2. Securities and Exchange Commission, Bulletin S-x, Rule 3-13, p.6.

cess provided an explanation of the circumstances is made. (1)

There were very few of the statements in this study that did not use the term "Current Assets." The non-use of the term "Current Assets" usually resulted from a difference in the set-up of the Balance Sheet as in the case of Westinghouse Electric Corporation. The term "current" is quite satisfactory in that its meaning is clear. The word connotes the same in general use as it does in accounting parlance. The difficulty arises in determining what items to include under the heading. There are some that are border-line cases, that is they may be included under "Current Assets" by some and under "Other Assets" by others.

One item of this type (doubtful as to position in the Balance Sheet) is accounts receivable from employees. There is a difference in the placing of this item. For example, Libbey-Owens-Ford Glass Company put this item under "Other Assets." The Philip Carey corporation in its Balance Sheet put the item under "Current Assets." Of course, some did not separate accounts receivable from employees from other accounts receivable, but of those who did, the treatment was divided as above. Regulation S-X of the Securities and Exchange Commission gives some in-

1. Securities and Exchange Commission, Bulletin S-X
Rule 3-13, p. 6

formation as to what shall be included under "Current Assets" and "Other Assets". Rule 5-02,7 is headed "Other Current Assets." The following quotation is taken from that paragraph: "(a) State separately (1) total of current amounts, other than trade accounts subject to the usual trade terms, due from directors, officers, and principal holders of equity securities other than affiliates." (1) Rule 5002, 21, headed "other assets" says "State separately (a) total of amounts due from directors, officers, and principal holders of equity securities other than affiliates." (2) The rule does not say so, but perhaps the difference here is one of time, those to be under "Other Assets" to be other than current.

One more example of the difference of what is included under the current assets heading is the item of advances or due from foreign subsidiaries. The Crane Company and McKesson and Robbins included in current assets the current receivables due from foreign subsidiaries and had a separate figure under "Other Assets" for the amount not current. Other statements did not do this, but instead, left the amount due from subsidiaries out of the current asset section and put it elsewhere on the balance sheet, usually under "Other Assets." Wilson

1. Securities and Exchange Commission, Bulletin S-X - p.14

and Company had a similar item in current assets, but under a different name, "Advances to affiliated companies" in the current assets section.

An example of dividing an asset item into two parts, one current and one not current, is in the Kaiser-Frazer Corporation Balance Sheet. Notes of the Graham-Paige Motor Company that fall due within one year are in the current asset section. Those that do not fall due within one year are in the fixed assets section.

As was stated above, there were but few differences in the use of the term "Current Assets." Standard Oil of New Jersey labeled the first asset section in their balance sheet "Current and Working Assets." The word "working" appears in two other statements in connection with current assets. They are United States Steel and the Caterpillar Tractor Company. These latter two companies presented their balance sheets in a different form. The first heading is "current assets." Then the current liabilities are deducted. The difference is labeled "Working Capital" in both cases. These were the only statements in which the term "working capital" or "working assets" was applied.

Armstrong Cork Company, in their "Statement of the Company's Position," makes no distinction between the various classes of assets, that is, there is no separa-

tion of current assets from fixed or other classes of assets.

Westinghouse Electric Corporation and United States Rubber do not head the section by any caption. The first sub-total in the Westinghouse balance sheet is "Current Assets." The first sub-total in the United States Rubber balance sheet is "Total (current assets)."

The only conclusion one might draw from a study of the current asset sections of these statements is that there is little variance in what the section is labeled. The difference lies mainly in what items are included under the heading "current assets."

The term "deferred charges" is used to mean prepayments of expenses that will occur in the future. Rule 5-02, paragraph 17, "Deferred Charges," of the S-X bulletin says that stated separately will be any significant items; however, prepayments of services to be received within a year may be included under "other current assets," and thus included in the current assets total. (1)

All except three companies stated the deferred charges item separately from the current assets. The three that included it under current assets were Kaiser-Frazer, Sears Roebuck and Company, and Chrysler Corporation.

1. Securities and Exchange Commission, S-X Bulletin, p. 13.

All the statements had an item that was a deferred charge except in the annual report of the Caterpillar Tractor Company. Thirty-one called the item "Deferred Charges." A number of these included other words along with the term "Deferred Charges" such as "Prepaid Expenses," "Patents and Deferred Charges", "Prepaid Assets," "Prepaid Supplies," "Prepaid Insurance," and several other similar items. Eight did not use the phrase "Deferred Charges." The terms "Prepaid Insurance," "Prepaid Expenses," or "Prepaid Accounts," were used in five cases: Kaiser-Frazer, Sears-Roebuck and Company, Boston Edison, Westinghouse Electric, and Chrysler Corporation. The heading used by Armstrong Cork was "Insurance, taxes, etc. paid in advance." In the American Telephone and Telegraph Company Balance Sheet there were two items under a heading "Deferred Debits." United States Steel gave this item the caption "Cost applicable to future period." Here was a very clear statement of what these figures were to represent. In the Westinghouse Electric Balance Sheet an even better caption as far as clarity is concerned was given the deferred charge item. That phrase was "Insurance pre-paid but applicable to future years."

In Accountant's Handbook, Paton says that the term "deferred charge" is generally objectionable in that it is

not sufficiently definitive. "All depreciable plant assets are deferred charges in the sense that they are to be absorbed against future revenues." He goes on to say that the term is applied to both short-term and long-term items and also to items properly treated as contra to liabilities or proprietorship items.⁽¹⁾

In Accounting Research Bulletin No. 9, a report of the Committee on Terminology of the American Institute of Accountants, there is the comment that a deferred charge is not an asset in the popular sense, but that it is an asset in the accounting sense.⁽²⁾

RESERVES

The term "Reserve" is used in every part of the balance sheet. There are asset reserves, liability section reserves, and capital or surplus reserves. Each type of reserve is for a different purpose and arises in a different manner. A reserve for depreciation is set up by a debit to an expense account and a credit to reserve for depreciation; a reserve for contingencies is set up by a debit to surplus and a credit to the reserve for contingencies account;

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1. Paton, W. H., Accountant's Handbook, p. 1190
 2. Accounting Research Bulletin #9 (special)
May, 1941, p.70.

sinking fund reserves result from a debit to surplus or to the sinking fund and a credit to the sinking fund reserve account. The word "reserve" is defined in the dictionary as follows: "That which is reserved; a store; stock; extra supply."⁽¹⁾ To one not thoroughly familiar with accounting principles or terminology, the term reserve may imply that there is some sort of fund set aside in the amount of the reserve--whatever the type of reserve. For sound financial reporting the item represented by reserves must be present in the financial statements. But in most instances some word or phrase other than "reserve" would better describe or present the facts. The word "reserve" occurred frequently on both sides of the balance sheet in the forty annual reports studied. On the following page is a table showing the frequency with which the word occurred.

1. Webster's Collegiate Dictionary, Fifth Edition, p. 847.

Table 1

Frequency of the Use of the
Word Reserve

Asset Section

<u>Frequency</u>	<u>No. of Statements</u>
0	7
1	2
2	11
3	16
4	2
5	1
6	0
7	0
8	<u>1</u>
	40

Liability and Net Worth
Section

<u>Frequency</u>	<u>No. of Statements</u>
0	6
1	10
2	8
3	11
4	4
5	<u>1</u>
	40

Accounting Research Bulletin Number 34, November, 1948, suggested to what uses the word "reserve" should I shall base most of my discussion of the word "reserve" around this bulletin. In this Bulletin, the Committee on Terminology of the American Institute of Accountants suggested that the use of the word "reserve" not be used when it is to mean any of three things: (1) deductions from an asset to show realizable amount, (2) uncertain future liability, and (3) a charge in the income statement to reduce amount at which an asset is stated. The recommended use of the word is to designate only those undivided or unidentified portions of assets held for a special purpose." (1)

In the first class mentioned in the foregoing quotation from the Journal of Accountancy are included such items appearing in the balance sheet as "reserve for bad debts, "reserve for inventory valuation," reserve for investments," or "reserve for depreciation." The Committee on Terminology said that this accounting usage of the term seems to be "contrary to the accepted meaning of the term." (2) The bulletin goes on to explain that such items as a reserve for depreciation or a reserve for bad debts do not mean that any retention or holding of assets has taken place. There is not necessarily a fund or asset set aside to take care of the expected loss.

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1. Journal of Accountancy, "Use of Word 'Reserve' Should be limited," November, 1948, p.409.
 2. Ibid., p. 410

The Committee suggested that the word "reserve" be abandoned when used in this sense and that some phrase such as "less estimated collectibles," "less estimated losses in collection," or "less amortization to date" be used. (1)

In these forty statements here are some instances of where the substitutes for the word "reserve" suggested by the committee or other variations were used:

"Allowance for depreciation"	Proctor and Gamble Co.
"Less amortization, depletion, and depreciation"	Aluminum Company of America
"Machinery, equipment, factory and office building after deducting the allowance for accumulated wear and use to date."	Armstrong Cork Company
"Receivables, less estimated bad debts."	United States Steel
"Building and equipment, less depreciation."	General Mills, Incorporated

These are examples of where the use of the word "reserve" has been abandoned without affecting the statement except perhaps making the valuation of the asset more readily understandable.

In an amendment to the British Companies Act it is provided that this type of reserve shall be described as a "provision." The Committee doubted whether this

1. Journal of Accountancy, "Use of Word 'Reserve' Should be Limited." November, 1948, p.411

would be any great improvement. (1)

One instance of elimination of the use of the word "reserve" for a deduction of an asset that I did not include on the foregoing page is found in the statement of financial position of the Caterpillar Tractor Company. That statement shows the following item: "Buildings, machinery, and equipment--cost allocable to future operations." This shows the assets at their depreciated value. In a statement on a following page in that annual report an item called the "Portion of above cost allocated to operations to date shown" is deducted from the cost of the assets. The difference is the figure appearing in the statement of financial position and is labeled "Cost not allocated to operations to date shown."

The second usage in which the committee on terminology advocated the abandonment of the use of the word reserve is in the case of a provision for an uncertain future liability. These are certain of the reserves that appear in the liability section of the balance sheet such as a "reserve for expected losses in connection with a law-suit." The word "reserve" is somewhat misleading here. Accounting Research Bulletin No. 34 says that it may be argued that the statement of any liability in the balance sheet is an indication that a portion of the assets will be required for its discharge.

1. Journal of Accountancy, "Use of Word 'Reserve' Should be Limited." November, 1948, P. 411

In this sense the statement may be regarded as a provision or reserve. (1) If this reasoning were followed, one could almost say that all liabilities should be called reserves. The Committee's recommendation was that it would be preferable to "regard the statement as indicating the obligation itself which is a deduction necessary to arrive at proprietary investment or net assets." (2) They suggested substitution of such terms as "estimated liabilities" or "liabilities of estimated amount" as designation for such items. (3) No such terminology appeared in the balance sheets of the annual reports in this study. In five reports, the footnotes to the balance sheet did explain that the purpose of the reserve was for an uncertain liability and did estimate that liability. There were seven statements in which a reserve of this type appeared. This does not include those reserves taken up in a later paragraph (which includes the reserves for contingencies, some of which may be for a purpose that would put them in this classification.) (However, in only three of those did the footnotes to the balance sheet indicate that they were reserves for an estimated liability.)

The third usage of the word "reserve" that the committee suggested be abandoned is a charge in the income statement to reduce the amount at which an asset is stated. This

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1. Journal of Accountancy, "Use of Word 'Reserve' Should Be Limited" November, 1948, p. 411.
 2. Ibid.
 3. Ibid.

would be where charges such as depreciation, amortization or depletion in the income statement are described as "Provisions" or "reserves." Bulletin 34 states that the basis purpose of these charges is the income measurement and it would be more understandable to designate these items as costs rather than as provisions or reserves.⁽¹⁾ The bulletin also states that the application of the word "reserve" here would lead to the reasoning that the function of depreciation accounting is one of replacement and that the provisions should be based on estimated future cost.⁽²⁾

There were no cases in these forty annual reports where the word "reserve" was applied as a part of a caption in the Income Statement. In twenty-five income statements, however, the word "provision" appeared. There were eleven "Provisions for federal tax" (before the net profit figure), five used "Provision for depreciation," one had "Provision for bad debts," and other Income Statements included provisions for "other adjustments" or for contingencies.

The Committee on Accounting Terminology said that the meaning of the word "reserve" corresponds closely to the "indication of an amount of unidentified or unsegregated assets held or retained for a specific purpose," and they suggested that the word "reserve" be limited in its use to this sense. (3)

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1. Journal of Accountancy, "Use of Word 'Reserve' Should Be Limited," November, 1948, p. 411.
 2. Ibid.
 3. Ibid.

This would include items such as "Reserve for general contingencies," "Reserve for replacement of property," "Reserve for inventory decline," or "Reserve for plant extension." Thirty-four of the annual reports had reserves of this type. A few explained in the footnotes to the balance sheet what those items were meant to be, what they were for, or to what use they would be put. (This explanation was especially needed in the case of some indefinite term such as for a "reserve for general contingencies") However, many did not explain at all the intended use of the reserve.

GOODWILL

Twelve balance sheets included an item called "Goodwill" in the asset section. In all of these but two, the word "Goodwill" was used with other words or items also represented in the figure. Among these were "patents," "licenses," "trade-marks," "copy-rights," "other intangibles," "water rights," etc. The number of words or other items used with the word "Goodwill" varied from only one to as many as four of those items listed above. Two of those that did not include "Goodwill" among their assets used a substitute word, "Intangibles." In both those cases the figure was only a nominal value.

Twenty-eight statements did not include goodwill among their assets. But of these twenty-eight, seven had

some item of intangibles. The most frequent was "patents." Four used only "patents," two, Kaiser-Frazer and United States Steel used the word "Intangibles." One placed the patents and other items in the deferred charge section. The tendency seemed to be to combine all the intangibles with goodwill, listing a few or generalizing by saying something like "Goodwill, patents, licenses, etc."

Intangibles usually include any of the following six items: Goodwill, patents and copyrights, trade-marks or trade-names, secret processes and formulas, going-concern value, and franchises.(1)

What does the word "intangibles" mean? Paton's Accountant's Handbook says this about the definition of intangibles: "Intangible" signifies lack of materiality, impalpability, and the intangible assets are in all cases immaterial or non-physical items." However, some immaterial assets not usually viewed as intangibles do exist or are at least recognized by law--e.g. rights or claims against other parties.(2)

"Goodwill" may be defined as the advantage or benefit had by a business beyond the value of its property used in the business, that it gains from its location, name or reputation, or habitual customers. (3) It is a term that connotes about

1. W. A. Paton, Accountants' Handbook, p. 837.

2. Ibid., p. 838.

3. Corpus Juris, Volume 28, Goodwill, p. 729.

the same thing both in the public mind and in the accountant's mind. The only question might be of how it has arisen. That is, whether by purchase or by "someone's just feeling it should be there." Conservative accounting practice frowns on placing the goodwill on the books without its being paid for. It is difficult to appraise or to prove an inherent value in intangibles. As mentioned above, the tendency of those companies having goodwill in their balance sheets was to include it along with other intangible items, not generally assigning a separate value to each item, but rather putting them together in a lump sum.

LIABILITIES AND NET WORTH

The right-hand side of the balance sheet contains the items making up the right-hand side of the accounting equation "assets equal liabilities plus net worth." There were eight different phrases used as headings for this section. All except two of those forms used the word "liabilities" as part of the heading. By far the most prevalent was the single word "liabilities," being used in twenty-six balance sheets. The following table shows the various forms of headings for the liabilities and net worth section and the frequency with which they occurred.

Table 2
Heading of
Liabilities and Net Worth
Section

<u>Heading</u>	<u>Frequency</u>
Liabilities.	26
Liabilities, Capital Stock and Surplus	5
Liabilities, Reserves, and Capital Stock	1
Liabilities and Capital	1
Liabilities, Reserves, Capital and surplus	1
The Companies Owe.	1
Liabilities and Net Worth.	1
The Company Owed	1
No heading for this section.	4

The heading "The Company owed" was on the first statement in the Armstrong Cork Company report. The heading "The Companies owe" was in the Westinghouse Electric annual report. This and the Armstrong Cork Company heading applied to the liabilities only and not to the net worth section also (as did the other headings.) In these two statements the form was not that of the equation stated above, but rather in the form "assets minus liabilities equal net worth."

From table 2 one can note that there is considerable uniformity regarding the terminology for this section of the balance sheet.

More than half of the annual reports, twenty-six, headed this section with only the word "Liabilities." This heading was over both the liabilities and the net worth. It would seem that a more inclusive heading such as "Liabilities plus net worth" would better describe the section. However, one company, the Diamond Match Company, did call their net worth a liability to the stockholder. I shall discuss that in more detail under the section "Net Worth."

Accounting Research Bulletin No. 9 defines a liability as a credit balance properly carried forward (provided it is not a negative balance applicable to an asset.) The word can be used in the broad sense to include other credits than those involving the ordinary debtor and creditor relationship. That is, it would include such credit items as capital stock, net worth, and deferred credits. The Bulletin comments on the headings of the liabilities and the net worth section by saying that terms such as "liabilities and other credits" as the titles of the right hand side of the balance sheet are "scarcely more illuminating than the heading "credits," without a drawing of a clear distinction between credits that are liabilities and other types of credits.(1)

CURRENT LIABILITIES

All except two companies labeled the first group of liabilities "Current liabilities" or "Current and accrued liabilities." Those two were Zenith Radio, which did not separate

1. Accounting Research Bulletin No. 9, May, 1941.

the types of liabilities, and Westinghouse Electric, which did include the phrase "Current liabilities" parenthetically under a total of the current liabilities. The use of "Current liabilities," then, was practically unanimous.

FIXED LIABILITIES

Fixed liabilities are those of a long-term nature. Under this heading come items such as long-term bonds or long-term notes. None of the annual reports in this study used the term "fixed" in connection with their long-term liabilities. Nine statements used the term "long-term debt." Two used the term "funded debt." Others used such phrases as "mortgage bonds" or "debentures" or listed the name of their particular type of bonds or long-term notes. One, Kaiser-Frazer, called the item after current liabilities "other liabilities." Fourteen had no caption for fixed liabilities or had no such item as fixed liabilities in the balance sheet.

One caption for fixed obligations that presented the item in a different manner was that in the Westinghouse Electric annual report. That caption was "Amount borrowed from the public." This does present the item in phraseology of a "folksy" type, but it leaves out any reference to the long-term nature of the debt. It seems that such a reference would be rather necessary here.

DEFERRED CREDITS

Only six of the annual reports included an item of deferred credits in the balance sheet. They were Libbey-Owens Ford Glass Company, General Motors, Northern States Power Company, New England Telephone and Telegraph, American Telephone and Telegraph Co., and Standard Oil of New Jersey. The last three companies called the item "Deferred credits." Libbey-Owens-Ford called it "Deferred income." General Motors placed it under "Reserves" and captioned the item "Deferred income." Northern States Power Company called it "Deferred liabilities."

Paton defines deferred revenues: ". . . advances by customers or clients which are subject to satisfaction by delivering of goods or services as agreed constitute a type of liability--often labeled, somewhat questionable, 'deferred revenues.'" (1)

NET WORTH

The third section of the balance sheet we shall discuss is the net worth section. This is the section that represents the "insiders' equity," the equity of the stockholders in the corporation. This section is made up of two principal parts, capital stock and surplus.

Of the forty annual reports, only two used the term "net worth" as a heading for this division of their balance sheets. Nineteen captioned it "Capital stock and surplus" or

"Capital stock and accumulated earnings." (The latter terminology was used in the Swift and Company balance sheet.) Fourteen companies gave no common heading for the items in the net worth section. Except for the public utilities these companies merely set the section apart from the liabilities and named the various items appearing therein.

In the five reports of public utilities, capital stock was the first item in the section headed "Liabilities" and surplus was the last item in the same section; thereby completely separating items of what in the other statements constituted the "Net worth" or last major section of the balance sheet.

In the remaining five annual reports the net worth section was captioned with a different phraseology in each case. The general theme expressed in the terminology used in these five cases was that the items in this section represented the net assets or source of the net assets of the corporation.

Chrysler Corporation called the section "Stockholders' Investment, represented by:" Then followed the capital stock and surplus items. Westinghouse Electric Corporation captioned the section "Stockholders' Equity (Net Worth)." United States Steel's caption for the section was "Ownership Evidenced by." Caterpillar Company gave it the heading "Source of Net Assets." Diamond Match Company used a different approach in their heading. Their caption was "Liability to Stockholders."

One can see in each of these an attempt to state in a few words a definition of what the sum of capital stock and

surplus represents. The first caption mentioned in the above paragraph, that used by Chrysler Corporation, states in effect that the "following items are amount invested in the business by stockholders." The caption used by Westinghouse Electric does about the same thing, as does the phrase "Ownership evidenced by" used in the United States Steel statement.

The Caterpillar Company's phraseology presents a similar thought in a slightly different manner. Here is carried through the thought that the net assets arise from a combination of the original investment (capital stock) plus the earnings kept in the business and employed in operations (surplus).

The terminology "liability to stockholders" used by the Diamond Match Company is unique in this group. It omits a reference to the capital stock and surplus as being ownership in the corporation, but rather places the stockholder in the position of a creditor. Now let us see by what reasoning this can be true.

The stockholders and the ordinary creditors and bondholders all have an equity in the corporation's assets. However, the type of equities these various classes have are different. The creditors and bondholders may be said to be outside creditors holding "outsiders' equity" in the corporate assets. Whereas the stockholders can be said to be inside creditors holding "insiders' equity" in the cor-

poration's assets. By this reasoning one can see that the amount in the net worth section of the balance sheet is a type of liability to the stockholders. One erroneous notion that may arise from such terminology is the idea that during the course of operations the corporation must pay off that liability. That is not entirely true, since the capital stock is a permanent investment. No repayment of capital stock is made in usual operations, only upon dissolution of the corporation.

As noted above, the largest group of the forty annual reports headed the net worth section with the caption "Capital Stock and Surplus." To most persons there would be no doubt what is meant by capital stock. Most people have some idea of what surplus is. In the next section, however, I shall show what these forty companies did with the item of surplus.

SURPLUS

The last item on the balance sheet to be discussed is surplus. The word "surplus" itself does not indicate what the account includes. A few of the statements studied did use other words to explain the item of surplus or state what the figure was made up of. One did not use the word "surplus" at all. The following is what the Committee on Terminology of the American Institute of Accountants said



about the word surplus in Accounting Research Bulletin
No. 12, September, 1941: "

"Indeed, it is hardly too much to say that the word 'surplus' as currently used is generally either non-descriptive or mis-descriptive, since in the public mind it has a connotation of value. The committee suggests that the general abandonment of the term would be a major step towards making the proprietorship section of the balance sheet more significant. It would lead to the substitution of really descriptive specific titles for uninformative classifications." (1)

Now let us see what some of the companies whose annual reports were part of this study have done with their surplus items. Of the forty statements, seven used words other than "Surplus" to describe that item. The balance of them used "Surplus," and split the account into two or more of the following parts: capital surplus, paid-in surplus, earned surplus, unearned surplus, unappropriated surplus, and reserved surplus. These last three items were found in the annual reports of public utilities.

Standard Oil of New Jersey called the surplus item "Earnings reinvested and employed in the business." That amounts to a definition of earned surplus. It has the quality of leaving little doubt in the reader's mind of what the item is made up of. First of all, it is made up of earnings (past or current); secondly, those earnings have been employed in the business in some way--new equip-

1. Accounting Research Bulletin, Report of Committee on Terminology, No. 12 (special), September, 1941, pp. 108-9

ment, working capital, etc. The caption does not connote a meaning that involves something not used or required for use in the business as the word "surplus" might do.

Under the caption "Source of Net Assets," the Caterpillar Tractor has two items, capital stock and "Profit employed in the business at the end of the year." This is essentially the same as the caption used by the Standard Oil of New Jersey. The same idea is expressed in a few more words.

The Chrysler Corporation statement has just about the same variation from "Surplus." Their surplus item is called "Net Earnings Retained for use in the Business." The Chrysler Corporation also has a capital surplus item. No change was made from the way the majority of the statements caption the item. The caption for capital surplus was "Additional Paid in Capital (Capital surplus)."

General Mills, Inc. in their annual report used the terms "Capital" and "Earned Surplus" combined with words similar to those used in the balance sheets mentioned above. Under the caption "Surplus" the following appears: "Capital (arising from amounts paid in by stockholders in previous years)" and "Earned (earnings reinvested in business), as per accompanying statement, page 21."

Under the caption "Ownership Evidenced by", in the "Consolidated Statement of Financial Position" of United

States Steel, the last item is "Income reinvested in the business."

So far all these statements have followed a similar pattern in their departure from the word "Surplus." They have more or less either defined surplus or have shown from where it has arisen. The balance sheet of Westinghouse Electric Corporation presents surplus in a similar way. Under a caption "Surplus", two items much like the form used by General Mills follow. They are "Income Retained in the Business" and "Amount Paid the Company for Capital Stock in Excess of par Value".

Most of these have used the word "surplus" and have included variations of the source of disposition of the item under that heading. Swift and Company do not use the word "surplus" in the net worth section of their balance sheet. The heading of the net worth section of the section of the Swift and Co. statement is "Capital Stock and accumulated earnings." The surplus sub-division of the section is as follows: "Accumulated earnings in use in business after providing above reserves." "Accumulated Earnings" has been the shortest phrase used as a substitute for "Surplus" in this group of statements.

It is well to define an item accurately by its caption, but brevity is also necessary lest the caption become unwieldy. "Accumulated earnings" seems to be satisfactory as a caption for the surplus item. It does not in itself,

say how the earnings are used as some of the captions discussed above have, but neither does the word "Surplus." This caption at least indicates the source of the accumulation. However, "earned" surplus is the only item for which "Accumulated Earnings" may be substituted. This caption could not be used where any other type of surplus is included. The other surplus items that arise from something other than earnings would have been given some other title. This was done in some of the balance sheets mentioned above. Consolidated Edison put their surplus under two heads, earned and unearned. This was the only report using the heading "Unearned Surplus".

The terms "unappropriated", "reserved", and "unearned" surplus, were used by three companies in the surplus section of their balance sheets. They were all public utilities.

In Armstrong Cork Company's Statement of Financial Position, the last, net worth, section is headed "Difference between What the Company Owned and What the Company Owed (Reserves and Stockholders' Funds)". The first item is a reserve for future needs under the employment benefit plan. The second is the investment of the stockholders (capital stock) and the third, the surplus item, is titled as follows: "Stockholders' past earnings reinvested in the business for the purchase of plants, equipment, and inven-

tories, and to strengthen the Company's financial condition (known as "Earned Surplus')." This leaves little to be asked for. Here again, the company has more or less defined surplus in the caption for the reader of the balance sheet. In the Balance Sheet of Armstrong Cork Company the headings used are "Surplus" and two sub-heads, "Paid-in" and "Earned Surplus."

To better judge the captions applied to the surplus accounts it would be well to define surplus and to determine what the figure includes. The paid-in or capital surplus represents an amount added to the net worth from sources other than the par value of the capital stock and net earnings. Earned surplus represents the accumulated net earnings that have not been paid out as dividends.

In Principles of Accounting, Intermediate, Finney says the following about surplus: "Surplus may be defined as that portion of a corporation's net worth not represented by its capital stock." (1)

The following definition of earned surplus was given by the Committee on Terminology of the American Institute of Accountants:

"Earned surplus is the balance of net profits, income, and gains of a corporation from the date of incorporation (or from the date when a deficit was absorbed by a charge against the capital surplus created by a reduction of the par or stated value of the capital stock or otherwise) after deducting losses and after deducting distributions to stockholders and transfers to capital-stock accounts when made out of such surplus." (2)

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1. H. A. Finney, Principles of Accounting, Intermediate Chapter 8, p. 127
 2. Ibid - p. 128

Regarding that definition by the Committee on Terminology, Finney states that from that definition it appears that earned surplus may properly include operating profits and extraneous profits (for example, profit on the sale of a fixed asset. (1)

The various captions discussed all seem to fit the definition (whether they have included only those things in the definition is another matter). The title "Accumulated Earnings" used in the Swift and Company balance sheet satisfies the definition quite well. There is no doubt left in the title that the figure has arisen from earnings and that it represents the earnings that have been kept in the business and not paid out in dividends. In addition, it is a short and workable caption. Some of the other captions perhaps are more inclusive, but they are quite long for general use.

"Capital" surplus refers to additions to the net worth other than net earnings from operations and extraneous income or par or stated value of capital stock. Among items that may give rise to capital surplus are premium on capital stock, donated surplus, and appraisal surplus. These and other similar items are included under the heading of capital surplus. Where the capital surplus item appeared it was called by that caption in nearly all

(1) H. A. Finney, Principles of Accounting, Intermediate Chapter 8, p.118

cases. The variations have been mentioned above. They were all cases of stating what the source of the capital surplus was, such as "Amount paid the Company for capital stock in excess of par value", used by the Westinghouse Electric Corporation in its balance sheet.



CHAPTER III

THE INCOME STATEMENT

The Income Statement is the statement that tells how much the company made on its operations during the last fiscal period. It begins with the sales. From that figure are deducted the cost of the goods sold and the other expenses. The difference is the net income or net profit.

HEADING OF THE STATEMENT

The most frequent form of title for this statement was "Statement of Income." In sixteen annual reports this statement was headed either "Statement of Income" or "Income Statement." Three were titled "Summary of Income." These three were Timken Roller Bearing, Zenith Radio Company, and General Motors Corporation. Two were entitled "Consolidated Income," and one, that of McKesson and Robbins, was titled "Consolidated Income, Profit and Loss." The income statement in the Texas Company annual report was titled "Statement of Income Accounts."

The next general type of headings for this statement was those using the words "profit and loss." Eleven income statements were headed either "Profit and Loss Statement" or "Statement of Profit and Loss." One, Carrier Corporation, was titled "Consolidated Profit and Loss."

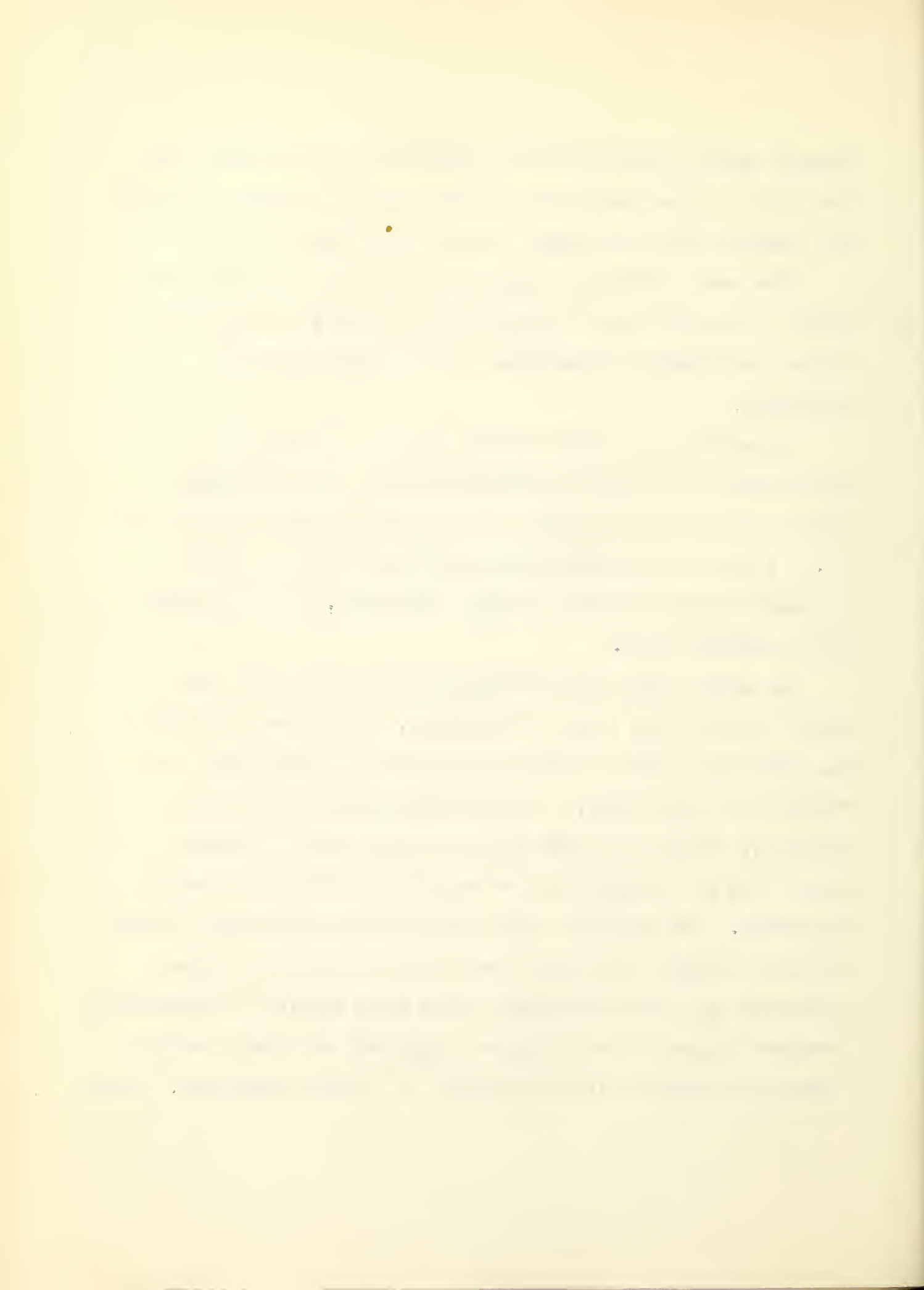
The word "operations" entered into the title in three cases. The titles given this statement by Westinghouse Electric was "Statement of Operations;" that given it by

General Mills Incorporated was "Results of Operations;" and the title of the Caterpillar Tractor Company income statement was "Results of Operations, Calendar Year 1947."

The word "earnings" appeared in the title to two statements. They were "Net earnings" in the Chrysler Corporation report and "Earnings Statement" in the Philco Company statement.

In addition to their "Profit and Loss Statement," Continental Can Company included another income statement headed "1947 in Brief, What we received and what we did with it." This statement contained the same results as their statement called "Profit and Loss Statement," but in a much more condensed form.

As noted above the word "income" was used more than either "profit and loss" or "earnings." The word "earnings" was used very little as were words such as "operations" or "results of operations." In Accounting Research Bulletin number 9, mention was made that the title should include words that would indicate the negative element if it were necessary. The Bulletin also indicated that the terms "profit and loss account" or "profit and loss statement" are more inclusive and more informative terms when applied to industrial concerns (as were most of these companies) and their results than such terms as "income account" or "income statement," since



the former supply the negative element. (1)

GROSS PROFIT

The first usual step in profit and loss statements having one or more steps before the net income figure is the gross profit or gross margin. This figure is the cost of goods sold subtracted from the net sales. It is the profit before deduction of operating and other expenses and consideration of financial expenses or income. Not all the profit and loss statements in this study included this step. A number of them, as will be noted later, were single-step statements.

The following terminology appeared in the forty reports for the first step in the profit and loss statement: "Profit on sales or gross profit," appeared twice; "Net manufacturing profit," once; "Net operating profit," once; "Profit from operations," once; "Gross profit on operations," once; "Operating profit," once; "Income from operations," once; "Net operating income," three times; "Gross profit," twice; "Profit from operations," once; "Net operating income," twice; and the phrase "Balance after all expenses," appeared once.

In seven profit and loss statements the gross profit step was not labeled. In each of these seven it also followed that none of the steps before the final net income figure were given a caption.

1. Accounting Research Bulletin #9 , May, 1941.

SINGLE AND MULTIPLE-STEP INCOME STATEMENTS

In fifteen annual reports there was no step between the sales figure and the net income figure. That is to say, they were single-step statements. In these statements the expense items and the cost of goods sold were all added together to arrive at a figure to be subtracted from the net sales; the resulting figure being net income.

Following is an array of the number of steps appearing before net income (before provision for federal income taxes. This demarcation was made because there was no uniformity in the point at which the provision for federal income taxes was made.)

Table 3

Number of steps in Income Statements

<u>No. of Steps</u>	<u>No. of Statements</u>
1	5
2	11
3	3
4	6
T otal	<u>25</u>

In three cases where there were two steps, the second step was labeled "gross income." These were all annual reports of public utilities. They added other income to the net operating income to arrive at gross income. Other expenses were deducted from the figure to arrive at their net income. In fourteen cases of multiple-step statements, the various steps

(not including the first* were not labeled, or, at most, one of three or four steps was given a caption.

Regarding the "gross-profit" idea, Paton states that it is not always possible to establish a clear-cut demarcation between the expenses relating to manufacturing and those relating to selling or administration. (1) In other words, it is not always possible to be certain that expenses belonging in the operating expenses are not included in the manufacturing expenses that have affected the gross profit item.

The following quotation is also from Paton's Accountants' Handbook regarding the term "gross profit."

"It would be a marked improvement in the nomenclature of income accounting if the term "gross" were restricted to total sales or volume of business in all cases. It might also be helpful if the term "income" were avoided until the net amount representing the return on total capital, before interest or income taxes, were disclosed." (2)

As the above quotation indicates, the word "gross" should be used to indicate the "whole" or "total." The Committee on Terminology of the American Institute of Accountants in Bulletin number nine, states that the term "Gross income" is used to indicate the remainder after deducting from sales those expenses "so closely associated with the production thereof as to be generally recognized as negative

1. Paton, W. A., Accountants' Handbook, p. 110.

2. Ibid.

elements in the computation of income. (1)

NET INCOME

The last step in the profit and loss statement, or at least the last step before showing the various dispositions of the income to the surplus account, dividends, reserves, and in some cases, taxes, is the "net income."

The words "net income" and "net profit" were almost universally used in the statements used in this study. Here is a distribution of the terms used as captions for this figure in the profit and loss statements.

Table 4
Net Income Captions

<u>Term</u>	<u>No. of stmts. appearing in</u>
Net income.	14
Net profit.	12
Net operating income.	2
Net Earnings.	2
Earnings	1
Earnings for the year	1
Profit for the year	3
Income.	2
Balance available after above expenses (Net Income).	1
Income transferred to earned surplus. . .	1
Income balance.	1

The Terminology Committee of 1931 of the American Institute of Accountants set forth uses of the words income, earnings, and profit which were then believed to be well established which I shall quote:

"Earnings applies to the operations of a concern rendering service, as distinguished from one selling commodities. Profits applies to manufacturing and mercantile concerns. Income, which sometimes is used by corporations, frequently as applied to net earnings applies more particularly to the compensation or profits received by a person." (1)

At the time Accounting Research Bulletin number nine was issued, May, 1941, the Committee on Terminology stated in that bulletin that they did not feel that they could at that time make a definite recommendation that would exclude the use of either income or profit and loss since there was considerable use of both. (2)

EXPENSES

Between the net sales figure and the net income, the variety of items seems to be almost infinite. No two statements include exactly the same items of cost nor do they group costs in the same manner. This is reasonable, because the deductions or additions in an income statement are purely individual matters with each company, and even vary from

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1. Accounting Research Bulletin No. 9, May, 1941.
 2. Ibid.

year to year with that company.

The first deduction from net income is usually the cost of sales. There was very little variation in this caption. Thirteen companies used the phrase "cost of sales." "Cost of goods sold" appeared in ten reports. In others, variations of these phrases were some such as "cost of materials," "cost of materials and services," or "cost of products sold." The results of one variation or another are just about the same as far meaning is concerned. They all are very clear statements of what the item is.

Among the expenses appearing in nearly every income statement was depreciation. The word depreciation was used in twenty-six statements. The depreciation charge was captioned either "depreciation" or "provision for depreciation." The latter term does more to identify it as a "book" charge.⁽¹⁾ Along with the word "depreciation" several companies used "amortization" or "depletion." These served to include other types of decreases in value of the assets.

Three companies termed the depreciation charge in a different manner. They were as follows: "Portion of Cost Allocable to operations," by Caterpillar Tractor Company; "Wear and Exhaustion of Facilities," by United States Steel; and "Wear of Facilities," by Westinghouse Electric Corporation.

1. Cf. discussion of Reserves, Chapter II, reference to British Companies Act.

There are certain items that are not usually included as charges against income in the income statement, but rather are items that belong in the surplus statement. These items are primarily such things as contingency reserves, inventory reserves, or other extraordinary items that would impair the the meaning of the income statement. Accounting Research Bulletin No. 35 recommends that these items be kept out of the income statement, and Bulletins 28, 31, 32, and 33 discuss treatment of certain of these items. (1) Generally, such items as these were placed in the surplus statement. However, in ten reports charges were made (before net income) for contingency reserves, inventory reserves, or reserves for loss on foreign exchange. None of these were combined income and surplus statements.

There was a tendency in all the income statements to keep the number of items (income or expense) down to a minimum. Some statements had as few as eight items in the income statement (e.g. Zenith Radio Corporation.) In most cases this was done by grouping large classes of expenses under one caption--that caption being a general term such as "operating expenses." The tendency was toward brevity and simplicity.

1. Accounting Research Bulletin No. 35, Dec., 1948.

CHAPTER IV

FORMS

In the appendix there is a table showing the forms used by the forty companies. Following is a numerical summary of that exhibit:

Table 5

Forms Appearing
in
Annual Reports

<u>Form</u>	<u>Occurring</u>
Balance Sheet.	18
Profit and Loss Statement.	11
Profit and Loss and Surplus.	7
Surplus Statement.	17
Comparative Balance Sheet	23
Comparative Profit and Loss Statement.	18
Comparative Profit and Loss and Surplus.	6
Comparative Surplus.	7
Application of Funds	1
Informal form Balance Sheet.	1
Informal form Profit and Loss Statement.	3
Capital Surplus Statement.	1

In addition to these forms, several companies included two to five other schedules. These constituted mostly things like schedules of the fixed assets, depreciation, fixed debt charges, etc.

Note that comparative statements were used by more corporations than was the non-comparative form. This may be the result of or an indication of a trend to use comparative forms. These forms have a very definite advantage in analysis of the progress

of the company. Thus they are particularly helpful to the investor or stockholder. When progress has been good, the comparative statement is helpful in presenting that fact (and is more likely to be used.) The comparative statement perhaps presents progress or changes more graphically than any narrative of what had happened.

In nearly all cases, the comparison was between the current year and the prior year. In the case of the Container Corporation of America, there were a balance and an income statement comparing two years and also a condensed form of each comparing twelve years. In the Caterpillar Tractor Company report there was a balance sheet and an income statement in condensed form comparing fifteen years.

Most of the balance sheets were of the balancing type--that is, the assets on the left equalled the total of the liabilities and net worth on the right. However, in three reports a different form was used (with variations.) Basically this form was as follows: Assets minus liabilities equals net worth. A variation in this was where the current liabilities were deducted from the current assets and fixed liabilities were deducted from fixed assets. The total being net worth. This form readily exhibits the current ratio and the ratio of fixed assets to fixed liabilities.

The "informal forms" of balance sheets or profit and loss statements were used by a few companies perhaps as an attempt to make up for the more formal language and form of

their principal statements. They are perhaps the result, also, of an attempt to make the statements and financial information understandable to the average reader. It is like telling a story in two ways, one "talking up" and one "talking down." It is a commendable procedure when they succeed in getting the point across to all classes of readers--no easy task.

The number and type of other schedules or forms varied with the requirements of each company. The other forms were usually schedules of fixed assets, reserves, inventories, etc. In addition to the financial schedules, some companies included schedules of production hours or other miscellaneous information, most of demonstrating the size of the company or its rate of production.

COMBINED INCOME AND SURPLUS

There were seven companies who used a combined income and surplus statement and six who used a comparative combined income and surplus statement. In Accounting Research Bulletins 28, 31, 32, and 33, alternative methods are recommended for showing items that are excluded from determining income. Such items may be either shown in a separate surplus statement or may be shown in the income statement after the net income figure. This latter method is best done by use of the combined income and surplus statement.

Examples of additions or deductions from the surplus, or income carried to surplus, are the following: Provision

for contingencies (Ralston-Purina Co.), Unused Reserve for Product Guarantees (National Battery Co.), Appropriation to Reserve for high cost additions to fixed assets (Swift and Co.)

In Bulletin No. 35, it was recommended by the Committee that the net income be shown "without deduction or addition of items which are properly excluded from the determination of net income." (1) It was not intended that this should preclude the use of the combined profit and loss and surplus statement provided the net income figure is "followed immediately by the surplus balance at the beginning of the period." (2)

One purpose of a combination of the income statement and the surplus statement is perhaps to show the disposition of net income for the year into the surplus account and how the income is affected by certain extraneous factors that have not been or may not be added or deducted before the net income figure. It has the advantage of continuity of the story of what happens to the income dollar. The whole thing is in one statement rather than two.

1. Accounting Research Bulletin No. 35, December, 1948.
2. Ibid.

CHAPTER V

CONCLUSIONS

I have incorporated my suggestions and the recommendations from other sources in the text. In this conclusion I wish to make note of a few other comments on the subject.

The Committee on Terminology of the American Institute of Accountants has made, and is making, a great deal of study on this subject. From time to time Accounting Research Bulletins have come out with the findings and recommendations of this committee on various subjects of terminology. In Accounting Research Bulletin No. seven, the Committee divided the words and phrases used in accounting into four classes. The first class included words and phrases that are fundamental in their use in accounting in senses somewhat at a variance with the meanings connoted in the public mind. (Such as "value," "assets," "liabilities," or "surplus") The second class is made up of those purely technical terms that have been developed by accountants and are in general unfamiliar to the public. (Such as "balance sheet," "double entry,") The third class is made up of words that are used in other fields, such as law, with which the accountant is concerned. The fourth class of words and phrases used in accounting is made up of terms that are used in auditing and not in accounting. (1)

1. Accounting Research Bulletin No. 7, November, 1940.

The Committee on Terminology planned to direct its attention to the first two classes.

The subject of terminology is important in that the public bases its opinion of both accounting and the companies whose annual reports they read on what they understand when they read financial statements. As suggested by Mr. M. H. Stans in an article in the Journal of Accountancy referred to in the introduction, the subject of terminology "deserves prompt attention, courageous action, and sound conclusions having the force of rules." (1) One place where a standard code of terminology has been set is in New Zealand. There a standard code of cost accounting terms was prepared by New Zealand's Accounting Terminology Committee and was published for trial use. (2)

In such a group as these forty annual reports used in this study there is a great deal of variation in usage of terms. The terminology situation is anything but static. Some terms are in the process of change due to custom or the desire to reach a different type of person as the reader for whom the report is intended. Other change is due to pronouncements of such bodies as the Terminology Committee of the American Institute of Accounts. The best example here is the suggestion in Accounting Research Bulletin

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1. M. H. Stans, "How New Standards of Financial Reporting Grow From Social Responsibility of Accountants," Journal of Accountancy, August, 1948, p.105.
 2. "New Zealand Standardizes Cost Accounting Terminology," Journal of Accountancy, September, 1948, p.200.

No. 34 where the Committee on Terminology recommended that the use of the word "reserve" be abandoned. These annual reports were issued before that bulletin, so they cannot reflect whatever effect that bulletin will have. The frequent and varied use of the word "reserve" shown in chapter two does emphasize the need for some substitute word or phrase.

The number of those who have made any drastic changes from the most common and traditional form and terminology are very few in this study. However, as has been shown here, these few have been very definite. They have changed both form and terminology. The tendency seems to be toward simplification. An effort is made to reach a new type of reader--the "man on the street." Business's interest in the ordinary man as an investor has been growing greater recently, as evidenced by education of the public in the process of investment being done by some firms. Perhaps the trend in financial reporting is to be the same.

A few of the corporations that did not change their principal statements did include what has been called an "informal" statement. These may be feelers to see what the reaction to such form and terminology would be.

Another group of those who have not changed form or terminology is the public utilities. These are bound by law in some instances, particularly within the same state,

as to their form and terminology with uniform accounting systems. There is little or no room for originality with them.

Meanings change and new concepts of phrases or words are arising constantly. Thus terminology must be flexible enough to meet a new situation, yet definite enough so that meanings are universal in all conditions and not misleading. It is not likely that the words to be used will in time be limited, but it is likely that the meanings will be more clearly set out so that a "reserve" means only one thing, a "deferred charge" means one thing, and so on through all accounting terminology.

A P P E N D I X

BALANCE SHEET TITLES,
ASSETS IN THE BALANCE SHEET Exhibit A

Balance Sheet Titles "Balance sheet"	Other Titles	No. of Sub-heads in assets	Current Asset Heads		Deferred Assets "Deferred Charge"	Deferred Assets Other	Goodwill & Intangibles		
			Current Assets	Others			None	"Goodwill"	"Goodwill" with Patents, etc
Aluminum Co. of America	X	6	X			Prepd exp. & def. charges	X		
American Tel. & Tel. Co.	X	3	X			Deferred debits	X		
American Woolen Co.	X	3	X			Deferred & other assets	X		
Armstrong Cork Co.	X	6	X			Prepaid insurance. . . .			X
Boston Edison Co.	X	7	X			Prepaid accounts	X		
Carrier Corp.	X	5	X			Prepd. expenses & def. charges			X
Caterpillar Tractor Co.	X		X						
Chrysler Corporation	X	3	X			Prepaid expenses	X		
Container Corp. of America	X	6	X			Prepd. & deferred charges			X
Continental Can Co.	X	6	X			Prepd. expenses & deferred assets	X		
Crane Company	X	4	X		X		X		
Diamond Match Co.	X	6	X			Def. charges to operations			X
General Mills Co.	X	5	X			Prepd. expenses & def. charges			X
General Motors Corp.	X	6	X		X				X
Hoover Ball & Bearing Co.	X	5	X		X		X		
Kaiser-Frazer Corp.	X	4	X			Prepaid Insurance			
Libbey-Owens-Ford Glass	X	7	X		X		X		
McKesson & Robbins Inc.	X	6	X		X			X	
National Battery Co.	X	5	X		X		X		
New England Tel. & Tel.	X	3	X			Prepd. Accts. & def. charges	X		
Northern States Power Co.	X	4	X		X		X		
Northwestern Public Service	X	4	X		X		X		
Philco Corporation	X	5	X		X		X		
Philip Carey Mfg. Co.	X	5	X		X		X		
Pittsburgh Steel Co.	X	5	X		X		X		
Proctor & Gamble Co.	X	5	X			Prepaid Exp. & Deferred charges			X
Radio Corporation of Am.	X	5	X		X		X		
Ralston Purina Co.	X	6	X		X				X
Remington Rand Co.	X	5	X		X			X	
Sears Roebuck & Co.	X	4	X			Prepaid.		X	
A.G. Spalding Bros., Inc.	X	4	X		X		X		
Standard Oil Co. (N.J.)	X	7		Current & working assets		Prepd. & deferred charges			X
Swift & Company	X	5	X			Prepd. ins. . . . & other def. charges.	X		
The Texas Company	X	5	X		X		X		
Timken Roller Bearing Co.	X	4	X		X		X		
U. S. Rubber Co.	X	4	X		X		X		
U. S. Steel Co.	X					Cost applicable to future period			
Westinghouse Electric Co.	X	7				Cost prepd but applicable to future yr.	X		
Wilson & Company	X	5	X		X				
Zenith Radio Corp.	X	7	X		X			X	X

LIABILITIES

Exhibit B

Company	Heading of Right Side of Balance Sheet			No common heading	Current Liabilities		Long-Term Debt	"Mortgage" used	Funded or Fixed Debt	None	Other
	Liab., Cap.Stk., & Surplus	Liab.	Other		Current Liab.	Current and Accrued					
Aluminum Company of America		X			X		X				
American Telephone & Telegraph		X				X			X		
American Woolen Company		X			X			X			
Armstrong Cork Company		X			X				X		
Boston Edison Company		X			X		X				
Carrier Corporation		X			X		X				
Caterpillar Tractor Co.			None, due to form								Debentures and notes
Chrysler Corporation				X	X						
Container Corp. of America		X			X					X	
Continental Can Co.	X				X						
Crane Company	X				X						
Diamond Match Company			Liab., Res., Cap. & Surplus			X					
General Mills Co.		X			X				X		
General Motors Corp.			Liab., Res., & Surplus		X						A list of long-term notes
Hoover Ball & Bearing Co.		X			X				X		
Kaiser-Frazer Corp.		X			X						"Other"
Libbey-Owens-Ford Glass Co.	X				X					X	
McKesson & Robbins, Inc.		X			X					X	
National Battery Company		X			X		X				
New England Tel. & Tel.		X				X			X		
Northern States Power Co.		X			X			X			
Northwestern Public Service		X			X						
Philco Corporation	X				X					X	
Philip Carey Mfg. Co.		X			X				X		
Pittsburgh Steel Co.		X			X				X		
Proctor & Gamble Co.		X			X		X				Debentures
Radio Corporation of Am.			Liabilities & Capital		X					X	
Ralston Purina Co.				X	X					X	
Remington Rand		X			X				X		
Sears Roebuck & Company		X			X					X	
A.G. Spalding & Bros., Inc.	X				X						Debentures
Standard Oil Co. (N.J.)			Liabilities & NetWorth		X				X		
Swift & Company		X			X		X				
The Texas Company		X			X		X				
Timken Roller Bearing Co.	X				X					X	
U. S. Rubber Company		X			X		X				
U. S. Steel Company				X			X				
Westinghouse Electric			The Companies Owe		X						Amount borrowed from the public
Wilson & Company				X	X			X			
Zenith Radio Corp.		X			No caption					X	

DEFERRED CREDITS - - EXHIBIT "C"

	<u>DEFERRED INCOME ITEMS</u>		
	<u>DEFERRED CREDITS</u>	<u>OTHER DEFERRED---</u>	<u>NONE</u>
Aluminum Co. of America			X
American Tel. & Tel. Co.	X		
American Woolen Company			X
Armstrong Cork Company			X
Boston Edison Company		Deferred Liabilities	
Carrier Corporation			X
Caterpillar Tractor Company			X
Chrysler Corporation			X
Container Corp. of America			X
Continental Can Company			X
Crane Company			X
Diamond Match Company			X
General Mills Company			X
General Motors Corporation		Deferred Income (under reserves)	
Hoover Ball and Bearing Co.			X
Kaiser-Frazer Corporation			X
Libbey-Owen-Ford Glass Co.		Deferred Income	
McKesson and Robbins Inc.			X
National Battery Company			X
New England Tel. & Tel. Co.	X		
Northern States Power Company			X
Northwestern Public Service Co.			X
Philco Corporation			X
Philip Carey Mfg. Company			X
Pittsburgh Steel Company			X
Procter and Gamble Company			X
Radio Corporation of America			X
Ralston Purina Company			X
Remington Rand			X
Sears, Roebuck and Company			X
A. G. Spalding Bros., Inc.			X
Standard Oil Company (N.J.)	X		
Swift and Company			X
The Texas Company			X
Timken Roller Bearing Co.			X
U. S. Rubber Company			X
U. S. Steel Company			X
Westinghouse Electric Corporation			X
Wilson and Company			X
Zenith Radio Corporation			X

NET WORTH AND SURPLUS HEADINGS Exhibit D

	Net Worth Section Headings			Stock		Surplus		Break-down of Surplus Items		
	Cap.Stk. and Surplus	No common heading	Other	Capital Stock	Pfd. and Common	Capital	Surplus Other headings - for surplus	Pd.in or Capital	Earned	Other types
Aluminum Co. of America		X		X				XC *	X	
American Tel. & Tel. Co.	X	X		X						Unapp.dr reserved.
American Woolen Co.				X			X	XP	X	
Armstrong Cork Co.	X				X		X	XC	X	
Boston Edison Co.		X		X					X	
Carrier Corporation	X				X.			XC	X	
Caterpillar Tractor Co.			Source of net assets	X			Profit empl.in the business.	.		
Chrysler Corp.			Stk.holders inv. rep. by.	X			Net earnings ret. for use in business.	XPC		
Container Corp.ofAmerica	X			X			X	XP	X	
Continental Can Co.		X		X				XC	X	
Crane Company	X			X				XC	X	
Diamond Match Co.			Liab.to Stk.holders	X					X	
General Mills Co.	X			X				XC	X	Reinvested earnings.
General Motors Corp.	X			X			X	XC	X	
Hoover Ball & Bearing	X			X.					X	
Kaiser-Frazer Corp.	X			X			X	XC	X	
Libbey-Owens-Ford Glass	X			X			X	XC	X	
McKesson & Robbins Inc.	X			X			X	XC	X	
National Battery Co.	X			X				Q	X	
New. Eng. Tel. & Tel. Co.		X		X						Unapprpriated & reserved.
Northern States Power Co.		X		X					X	
Northwestern Public Serv.		X		X				XP	X	
Philco Corporation	X				X		X	XC		Surplus
Philip Carey Mfg. Co.		X		X			X	XC	X	
Pittsburgh Steel Co.		X		X				XC	X	
Proctor & Gamble Co.	X				X			XP	X	
Radio Corp. of America		X		X					X	
Ralston Purina Co.		X		X			X	XC	X	
Remington Rand					X		X	XC	X	
Sears Roebuck & Co.		X		X					X	
A.G. Spalding Bros.,Inc.	X				X		X		X	
Standard Oil (N.J.)			Net Worth			X		XC	X	
Swift & Company			Cap.Stk.& Accrued Earnings	X			Accumulated earnings			
The Texas Company	X			X				XC	X	
Timken Roller Bearing Co.	X			X					X	
U. S. Rubber Co.		X		X			X	XC		
U. S. Steel Co.			Ownership evidenced by		X		Inc. invested in the business			
Westinghouse Electric Co.			Stk.holders equity	X			Inc. ret.in business			
Wilson & Co.	X			X					X	
Zenith Radio Corp.			Net Worth	X					X	

*XC--Capital Surplus
XP--Paid-in Surplus

TITLES OF INCOME STATEMENTS

Exhibit E

	Captions Using "Income"	Captions using "Profit and Loss"	Captions using "Earnings"	Captions Using "Operations"
Aluminum Co. of America	Consolidated Income			
American Tel. & Tel. Co.	Income Statement			
American Woolen Co.	Statement of Income			
Armstrong Cork Col		Stmt. of Profit & Loss		
Boston Edison	Statement of Income			
Carrier Corporation		Consol. Profit & Loss		
Caterpillar Tractor Co.			Results of Net earnings	Results of operations
Chrysler Corporation				
Container Corp. of America		Stmt. of Profit & Loss		
Continental Can Co.		Profit & Loss Stmt.		
Crane Company		Profit & Loss Stmt.		
Diamond Match Co.	Stmt. of Income			
General Mills Co.				Results of operations
General Motors Co.	Summary of Consol. Income			
Hoover Ball & Bearing		Profit & Loss Stmt.		
Kaiser-Frazer Co.		Profit & Loss Stmt.		
Libbey-Owens Ford Glass		Profit & Loss Stmt.		
McKesson & Robbins	Consol Income Profit and Loss			
National Battery Co.		Stmt. of Profit & Loss		
New England Tel. & Tel.	Income Statement			
Northern States Power	Statement of Income			
Northwestern Public Serv.	Statement of Income			
Philco Corp.			Earnings statement	
Philip Carey Mfg. Co.	Statement of Income			
Pittsburgh Steel Co.	Statement of Income			
Proctor & Gamble		Stmt. of Profit & Loss		
Radio Corp. of America	Statement of Income			
Ralston Purina Co.		Stmt. of Profit & Loss		
Remington Rand	Statement of Income			
Sears Roebuck & Co.	Statement of Income			
A.G. Spalding & Bros.		Profit & Loss Stmt.		
Standard Oil (N.J.)	Income Statement			
Swift & Co.	Statement of Income			
The Texas Co.	Stmt. of Income Accounts			
Timken Roller Bearing	Summaries of Income			
U. S. Rubber Co.	Consolidated Income			
U. S. Steel Co.	Statement of Income			
Westinghouse Electric				Statement of operations
Wilson & Co.	Statement of Income			
Zenith Radio Corp.	Summary of Consol. Inc.			



ITEMS OF THE INCOME STATEMENT Exhibit F

	Captions Used for Gross Profit	No. of Steps before Net Income	"NET INCOME"		Other
			"Net Profit" used	"Net Income" used	
Aluminum Co. of America				X	
American Tel. & Tel. Co.	Net Operating Revenue	1			Net operating income
American Woolen Co.	Profit on Sales	2		X	
Armstrong Cork Co.	Profit from operations	2		x	
Boston Edison Company	Net operating income	2		X	
Carrier Corporation	Gross(operating)profit	4	X		
Caterpillar Tractor Co.					Profit for the year.
Chrysler Corporation					Net earnings
Container Corp of America	Gross profit on operations	4	X		
Continental Can Company				X	Balance available after above expenses.
Crane Company	Net operating profit	2	X		
Diamond Match Company	Net operating income	2			Income Balance
General Mills Co.					Earnings for the year
General Motors Co.				X	
Hoover Ball & Bearing Co.		3	X		
Kaiser-Frazer Corp.		2	X		
Libbey-Owens Ford Glass Co.	Net Mfg. Profit	2	X		
McKesson & Robbins Inc.	Gross Profit on Sales	4	X		
National Battery Co.		2	X		
New England Tel. & Tel. Co.	Net Operating Revenue				Net operating income
Northern States Power Co.	Net Operating INcome	2		X	
Northwestern Public Service	Net operating income	3		X	
Philco Corporation		4			Earnings
Philip Carey Mfg. Co.	Profit from operations	2		X	
Pittsburgh Steel Co.					Profit for the year
Proctor & Gamble Co.	Profit from operations	2	X		
Radio Corporation of Am.				X	
Ralston Purina Co.		1	x		
Remington Rand					Income transferred to earned surplus
Sears Roebuck & Co.				X	
A.G.Spalding & Bros., Inc.		4			Net Earnings
Standard Oil Co. (N.J.)		1		X	
Swift & Company				X	
The Texas Company	Income from operations	3	X		
Timken Roller Bearing Co.				X	Income
U. S. Rubber Co.		4		X	
U. S. Steel Corp.					Income
Westinghouse Electric				X	
Wilson & Company				X	
Zenith Radio Corp.	Operating Profit	1			Profit for the year.

FORMS USED

EXHIBIT G

[illegible]

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